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Supreme Court, U.S.
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No. 04-173

IN THE

Supreme Court of the United States

RICHARD A. QUINN and SCOTT W. TUCKER,

Petitioners,

v.

SECURITIES AND EXCHANGE COMMISSION,

Respondent.

ON PETITION FOR WRIT OF CERTIORARI TO THE
UNITED STATES COURT OF APPEALS
FOR THE FIFTH CIRCUIT

REPLY BRIEF

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ARGUMENTS IN REPLY TO THE BRIEF FOR THE RESPONDENT IN OPPOSITION

I. The Respondent's interpretation of "profits" is misplaced and ignores Fifth Circuit precedent that disgorgement is not punitive in nature.

The district court ordered the Petitioners to disgorge $7.5 million, which was the total amount the Commission contended United Energy had raised from investors between June 1995 and January 1998. This amount represents the entirety of the *proceeds* obtained by United Energy, not the *profits* Petitioners received from their involvement with United Energy. As such, the entire disgorgement award amounts to an improper penalty.

A. A party is only required to disgorge its profits, not all of the proceeds, resulting from the fraudulent activity.

The law is settled that a party is only required to disgorge its *profits* resulting from a fraud. *See Commodity Futures Trading Comm'n v. Sidoti*, 178 F.3d 1132, 1138 (11th Cir. 1999) (noting that a district court may not disgorge profits obtained without the aid of any wrongdoing)[1]; *SEC v. Patel*, 61 F.3d 137, 139 (2d Cir. 1995) (stating that "disgorgement need only be a reasonable approximation of the profits causally connected to the violation"); *SEC v. Bilzerian*, 29 F.3d 689, 697 (D.C. Cir. 1994) (upholding the district court's order reasonably approximating illicit profits); *Commodity Futures Trading Comm'n v. Am. Metals Exch. Corp.*, 991 F.2d 71, 77 n.10

1. Cases involving the Commodity Exchange Act have followed the rationale supporting disgorgement in actions under the securities laws—that allowing a violator to retain the profits from his violation would frustrate the purposes of the regulatory scheme. *Id.* at n.9. Thus, the law applied in cases involving the Commodity Futures Trading Commission also applies to cases where the Securities Exchange Commission is a party.

(3d Cir. 1993) (holding that a trial court abused its discretion by not holding a hearing to determine the amount of illegal profits); *SEC v. Blatt*, 583 F.2d 1325, 1335 (5th Cir. 1978) (holding that the district court had the equitable power to order a party to disgorge only those amounts with interest by which the party profited from his wrongdoing).

The term "profit" is not defined by the Securities Exchange Act. "Profit" must, therefore, be assumed to have its ordinary or usual meaning: the excess of revenues over expenditures in a business transaction. *Heli-Coil Corp. v. Webster*, 352 F.2d 156, 168 (3d Cir. 1965); BLACK'S LAW DICTIONARY 1226 (7th ed. 1999). Here, that would include only the profits Quinn and Tucker received from their involvement with United Energy, not the entire proceeds of $7.5 million. The summary judgment evidence showed, and the district court found, that Petitioners' realized no more than $796,000 in profits. (Pet. App. 24a-25a, Findings 43, 54, and 55). Those profits included money spent for Petitioners' personal expenses, payment of overrides, and money received from Petitioners' employment with United Energy. (*Id.*). The district court's decision to order disgorgement of all proceeds raised is, thus, contrary to its own findings that Petitioners received only $796,000 in profits. Similarly, that decision disregarded summary judgment evidence that some programs turned a profit for investors, while others returned the contributions of several investors to those investors. This evidence further shows that the $7.5 million did not reflect Petitioners' profits. Rather, some of those proceeds were ultimately returned to investors as profits.

This decision also contradicts decisions from the majority of Circuit courts, including the Fifth Circuit, that have addressed the calculation of disgorgement amounts. For example, in *Blatt*, John Pullman purchased certain shares of stock for $59,662. *Blatt*, 583 F.2d at 1327. Six months later, Pullman sold the stock for $375,000, giving Pullman a profit of approximately $315,000. *Id.* at 1328. The district court ordered Pullman

to disgorge only the $315,000 in actual profits. *Id.* at 1335. The Fifth Circuit affirmed, holding that the disgorgement amount properly represented the amount of the defendant's ill-gotten gain. *Id.* Had the district court and Fifth Circuit followed *Blatt* in this case, the disgorgement amount could not have exceeded $796,000. A writ of certiorari is necessary to correct the conflict created by the erroneous decision to order disgorgement of the entire $7.5 million in investment funds.

B. The district court's failure to offset the disgorgement amount with legitimate business expenses resulted in a punitive award.

The Fifth Circuit also improperly refused to offset the disgorgement amount with legitimate business expenses. As noted *supra*, a disgorgement award should not exceed the profits actually gained by the wrongdoer. Here, the district court's disgorgement order far exceeds the profits realized by Petitioners and fails to take into account the monies used by United Energy for legitimate business expenses.

Although Respondent correctly states the general rule that disgorgement awards *may* be offset by legitimate business expenses in furtherance of the participants' investment objectives, reliance on the discretionary "may" language goes against Fifth Circuit precedent discussing the purpose of disgorgement. *See SEC v. Blatt*, 583 F.2d 1325 (5th Cir. 1978). In *Blatt*, the Fifth Circuit unequivocally stated that disgorgement is not punitive. *Blatt*, 583 F.2d at 1335. The court further held that a court's disgorgement power "extends only to the amount with interest by which the defendant profited from his wrongdoing." *Id.* Thus, a court must consider legitimate business expenses as an offset to a disgorgement award so as to ensure that a party is not being punished in excess of the amount from which he profited.

Although the case law relied upon consists of opinions from district courts, this should not hinder the Court's review of the issue. This situation is not an isolated one. On the contrary, the lower courts must frequently determine disgorgement awards. Unfortunately, the Fifth Circuit does not uniformly offset legitimate business expenses against disgorgement awards. Rather, the Fifth Circuit, as in this case, includes legitimate business expenses, which results in a windfall to the opposing party in the amount of damages awarded. By so doing, the Fifth Circuit has disregarded well-established precedent and thwarted the very purpose of disgorgement (i.e. to force a defendant to give up the amount by which he was unjustly enriched and not to unfairly penalize him). If this Court does not correct the Fifth Circuit's error, this injustice will frequently recur, placing future defendants at risk for punitive disgorgement awards. As such, granting the Petition on this issue is warranted and necessary to protect Quinn's and future defendants' due process rights. Moreover, the likelihood that this error will recur is so great that the Court should address this issue now, rather than allowing the issue to unnecessarily percolate further in the district courts. A writ of certiorari is, thus, necessary to ensure that neither Petitioners nor future litigants are forced to endure a punitive disgorgement award.

II. Petitioners have not waived their argument regarding prejudgment interest because the proper calculation of prejudgment interest is directly tied to the question presented regarding the proper calculation of disgorgement damages.

Supreme Court Rule 14.1(a) states in part "the statement of any question presented is deemed to compromise every subsidiary question fairly included therein." Sup. Ct. R. 14.1(a); *see also Yee v. City of Escondido*, 503 U.S. 519, 537 (1992). Since the district court's errors in determining a disgorgement amount make its award of prejudgment interest improper, Petitioner's prejudgment interest argument is a subsidiary

question of the disgorgement issue and did not need to be presented as a separate issue under Rule 14.1(a).

Further, Rule 14.1(a) serves two important and related purposes: to provide respondents with notice of the grounds upon which petitioner is seeking certiorari and to assist this Court in selecting cases to grant review. *Yee*, 503 U.S. at 537. By not presenting their prejudgment argument as a separate issue, Petitioners have not frustrated either of these stated purposes. Petitioners' briefing of this issue in their Petition gave Respondent fair notice that Petitioners have brought the issue of prejudgment interest to the Court. As such, the purposes of Supreme Court Rule 14.1(a) have been met, and Petitioners have not waived their argument. Petitioners respectfully pray that the Court address the issue of whether the Fifth Circuit improperly awarded prejudgment interest in conjunction with the issue regarding whether the disgorgement amount was proper.

CONCLUSION

Petitioners Richard A. Quinn and Scott W. Tucker, therefore, respectfully pray that the Court issue a writ of certiorari to review the Fifth Circuit opinion in this case.

Respectfully submitted,

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